IN THE SUPREME COURT
STATE OF MICHIGAN
(On Appeal)

INTERNATIONAL HOME FOODS, INC.,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant

Supreme Court No. 130542
Court of Appeals No. 253748
Court of Claims No. 02-000081-MT

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LENOX, INCORPORATED,

Plaintiff-Appellee

v

DEPARTMENT OF TREASURY,

Defendant-Appellant

Supreme Court No. 130542
Court of Appeals No. 253760
Court of Claims No. 01-18141-MT

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**AMICUS CURIAE BRIEF OF COUNCIL ON STATE TAXATION IN SUPPORT OF PLAINTIFFS-APPELLEES**

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## QUESTIONS PRESENTED

I. Does the Department's retroactive imposition of a nexus standard for the Michigan Single Business Tax violate the 14th Amendment Due Process rights of taxpayers who had been expressly advised by the State that they were not subject to the tax?

Plaintiffs-Appellees, International & Lenox say, "Yes."
Defendant-Appellant, Department of Treasury says, "No."
The Court of Appeals did not decide this question.
Amicus Curiae, Council On State Taxation says, "Yes."

II. Should the Department be bound by its published guidance when taxpayers have relied on that guidance to their detriment?

Plaintiffs-Appellees, International & Lenox say, "Yes."
Defendant-Appellant, Department of Treasury says, "No."
The Court of Appeals says, "Yes."
Amicus Curiae, Council On State Taxation says, "Yes."

# I.
# INTRODUCTION

The substantive issue in this case is whether the State's retroactive imposition of a nexus standard (for the Michigan "Single Business Tax" or "SBT" (MCL 208.1 *et seq.*, "Single Business Tax Act")) violates the Due Process rights of taxpayers who had been expressly advised by the State that they were not subject to the tax. The overarching policy concern is whether Michigan will tolerate its executive branch agency (the Department of Treasury or "Department") acting to induce taxpayers to rely on agency published guidance and then unnecessarily seeking to retroactively tax those same taxpayers when the guidance is judicially determined to be incorrect. Both the legal and policy arguments support the taxpayers' position in this case and justify upholding the Court of Appeals' decision below. The State's executive branch should not be allowed to penalize taxpayers for errors in its own guidance. Not only should such action be against the State's public policy, it is a violation of taxpayer Due Process.

The Council on State Taxation ("COST") supports Plaintiffs-Appellees, International Home Foods, Inc. ("International") and Lenox, Inc. ("Lenox"), in their opposition to the effort by the Defendant-Appellant, the Department of Treasury (the "Department"), to seek reversal of the Michigan Court of Appeals' October 4, 2005 opinion in Docket Nos. 253748 and 253760. That decision struck down the Department's retroactive application of a jurisdictional standard for the Michigan SBT. The new standard was announced in *Gillette Co v Dep't of Treasury*, 198 Mich App 303; 497 NW2d 595 (1993), and reversed the Department's prior published jurisdictional standard used to determine whether a corporation was subject to the SBT. International and Lenox, as well as many other multistate taxpayers, relied on the Department's position, articulated in several formal pronouncements that were the standing guidance for over 13 years, as the basis for decisions in structuring their business transactions and reporting their tax obligations.

Prior to *Gillette*, the Department had taken the position that the proper jurisdictional standard for application of the SBT was that announced in Public Law 86-272 (codified at 15 USC 381-384). That statute, enacted in 1959, prohibits states from imposing income tax on companies whose only activity in a state is the solicitation for sales of tangible personal property. While the federal statute is not a nexus standard *per se*, it sets a jurisdictional standard for imposition of income tax. The Department, even though it was clear that the SBT was not a traditional income tax, announced that taxpayers were protected if their presence in the state was below the standards established in PL 86-272. This position was first announced in 1980 when the Department issued Single Business Tax Bulletin (SBTB) 1980-1 and again in 1989 when it issued Revenue Administrative Bulletin (RAB) 1989-46. In each of these bulletins, the Department advised Appellees and taxpayers at large that the standard for determining taxability under the SBT was the standard established in PL 86-272.

Shortly before issuing its second bulletin described above, the Department specifically assured International, Lenox and other COST members that they could rely on Departmental advice **unless and until** the guidance was revoked or modified. The Department took this position in RAB 1989-34 which expressly assured taxpayers that the State's bulletins "ha[ve] the status of precedent in the disposition of cases unless and until revoked or modified, and may be relied on by taxpayers...". RAB 1989-34 at 1. Four years after the Department issued its last guidance on the jurisdictional standard, the

*Gillette* Court, *sua sponte*, applied a **substantial** nexus standard to the SBT, effectively expanding the tax base tax to thousands of out-of-state taxpayers. Under *Gillette*, the Commerce Clause of the United States Constitution (US Const, art I, §8) provides the limitation on the State's jurisdiction to impose the SBT; not the higher threshold provided by PL 86-272. The Commerce Clause requires only substantial nexus in a state to subject a corporation to the state's tax while PL 86-272 prohibits a state from taxing a corporation with physical presence in the state if that presence consists merely of solicitation for sales of tangible personal property. Taxpayers had previously been advised that they were protected by, and could rely on, the Department's bulletin that administratively adopted PL 86-272 as the standard and were caught without notice by the *Gillette* Court's decision. Even more surprising however was the Department's unfortunate decision to apply the new standard retroactively.

COST and its membership are outraged that the Department would retroactively attempt to impose the new jurisdictional standard after having promulgated bulletins advising taxpayers to rely on PL 86-272 and guaranteeing the binding effect of these bulletins. Having made such a guarantee, the Department should not be allowed to alter its position retroactively. Retroactive application of the change would be particularly damaging to taxpayers that relied on the Department's advice and included the relevant protected income (which the Department now seeks to tax) on the tax return for their home state. Because the statute of limitations has expired on these taxpayers' ability to claim a refund, the Department's position will result in double taxation.

## II.
## ARGUMENT

### A. **<u>Does the Department's Retroactive Imposition of a Nexus Standard for the Michigan SBT Violate the 14th Amendment Due Process Rights of Taxpayers Who Had Been Expressly Advised by the State That They Were Not Subject to the Tax?</u>**

The Fourteenth Amendment of the U.S. Constitution grants substantive protection against deprivation of life, liberty, or property without due process of law. US Const, Am XIV, §1. The Supreme Court in *Welch v Henry*, 305 US 134; 59 S Ct 121; 83 L Ed 87 (1938) set the standard for determining whether the retroactive imposition of tax infringes upon due process. According to the Court in *Welch*, it is "necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation." *Id.* at 147. More recently, the Supreme Court has also factored notice into the determination of whether the retroactive application of tax laws violates due process. In *United States v Hemme*, 476 US 558; 106 S Ct 2071; 90 L Ed 2d 538 (1986), the Supreme Court identified one of the relevant circumstances to be "whether, without notice, a statute gives a different and more oppressive legal effect to conduct undertaken before enactment of the statute." The Supreme Court in *Carlton* also determined that lack of notice, although not dispositive, is clearly relevant to the due process analysis. *United States v Carlton*, 512 US 26; 114 S Ct 2018; 129 L Ed 2d 22 (1994).

The Department's retroactive assessment of International and Lenox raises serious constitutional concerns under the standards set out in *Welch, Hemme* and *Carlton*. While the present case does not involve the legislation at issue in *Welch, Hemme* and *Carlton*, it does present an even more egregious retroactive tax imposition than was challenged in those cases. From 1980 to 1993, the Department informed International, Lenox, and other out-of-state taxpayers, through Revenue Administrative Bulletins, that they would not be subject to the SBT if they fell below the threshold articulated by PL 86-272. Until the *Gillette* decision was entered in 1993, there was no indication that the Department's interpretation of the jurisdictional standard was incorrect.

**B. *Carlton* Prohibits the Retroactive Application of the SBT Nexus Standard.**

In *Carlton*, *supra*, which is the most recent and influential Supreme Court case dealing with this issue, the court articulated a two-part test to determine if retroactive tax legislation violates due process. First, the Court looked at whether the purpose of adopting the law was illegitimate, arbitrary, or based on an improper motive, such as targeting a taxpayer after deliberately inducing them to engage in a transaction. *Id.* at 32. Second, the Court looked at whether the period of retroactivity was modest. *Id.* These tests, when applied to the Department's action in the present case, support the conclusion that the Department's retroactive imposition of tax violates due process.

The first prong of the two-part *Carlton* test is not satisfied; the Department's purpose in retroactively imposing tax on the out-of-state companies was illegitimate, arbitrary, and based on an improper motive, because the Department specifically targeted taxpayers after inducing them to engage in transactions. The Department issued guidance to taxpayers expressly encouraging them to rely on that guidance in organizing and conducting their business operations in Michigan. Out-of-state taxpayers were told that they were not subject to the SBT if they conducted business within the limitations of PL 86-272. Based on that guidance and assurance, taxpayers organized their business operations accordingly and engaged in limited business in Michigan. These taxpayers were further told that the Department's guidance had the force of law and was binding until expressly revoked. For 13 years the Department informed out-of-state taxpayers that they would not be subject to the SBT if they met the standard established by PL 86-272. After encouraging taxpayers to rely on the Department's published guidance to structure their business operations, the Department now uses *Gillette* to justify targeting of out-of-state businesses for retroactive assessment. The Department's retroactive imposition of tax is undoubtedly the type of improper motive *Carlton* was intended to prevent – specifically targeting taxpayers after inducing them to engage in transactions.

The second prong of the two-part *Carlton* test is also not satisfied; the period of retroactive imposition was not modest. While the *Carlton* court did not establish a bright line rule for determining what is considered a modest period of retroactivity, Justice O'Connor in her concurring opinion declared that "[A] period of retroactivity longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions." *Id.* at 38 (O'Connor, J., concurring). State courts looking at this issue have agreed. In *Rivers v State*, 327 SC 271; 490 SE2d 261 (1997), the South Carolina Supreme Court invalidated the retroactive application of tax legislation to tax years two to three years before the legislation was enacted. In reaching its decision, the court cited *Carlton* for the proposition that tax legislation with a period of retroactivity greater than one year is constitutionally suspect. *Rivers*, 327 SC at 277-78. Following this trend, the Kentucky Court of Appeals recently held that a period of retroactivity in excess of five years was a violation of taxpayers' due process rights. *Johnson Controls, Inc v Rudolph*, __ SW3d __, 2006 WL 1195498 (Ky App, 2006). Relying on *Rivers*, the court held that "[w]e agree with the Supreme Court of South Carolina's learned opinion that '[a]t some point...the government's interest in meeting its revenue requirements must yield to taxpayers' interest in finality regarding tax liabilities and tax credits.'" *Id.* at 6, quoting *Rivers*, 327 SC at 279.

With respect to the two taxpayers at issue in the present case, the period of retroactivity reaches back four years from the date of the 1993 *Gillette* decision. The Department assessed Lenox back to its tax year beginning May 1, 1989; International was assessed back to its tax year beginning January 1, 1989. This four year period of retroactivity would not be tolerated under *Carlton.*

For the hypothetical taxpayer, the possible period of retroactivity is virtually unlimited. Because taxpayers who relied on the Department's guidance would not have filed SBT returns, the statute of limitations on a retroactive assessment does not begin to run. Thus, the Department is not prohibited from imposing retroactive SBT liability back to the year in which the taxpayer began conducting business in the state or the date the SBT was originally enacted in 1976, 17 years before the *Gillette* decision was handed down. This unbridled retroactivity, while not accomplished by legislation, should not be tolerated simply because it is accomplished by executive branch fiat. Such an outrageous period of retroactivity is not to be tolerated under *Carlton*.

*Carlton* also gave consideration to whether the taxpayers had notice of the potential retroactive liability in determining whether the imposition violated due process. Here, International and Lenox had no reason to be on notice of potential liability for SBT. Until the *sua sponte* decision by the *Gillette* court in 1993, even the Department had no idea that the longstanding, administratively applied jurisdictional standard would be *sua sponte* eradicated.

Finally, *Carlton* gave significant weight to the importance of taxpayer certainty. According to Justice O'Connor's concurring opinion, "the governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose." *Carlton*, 512 US at 37-38 (O'Connor, J., concurring). Allowing the Department to retroactively assess tax back to 1989, the same year the Department assured taxpayers that its bulletins could be relied upon as binding, erodes the ability of taxpayers to achieve certainty and finality in their tax obligations and thus destroys the credibility of the state in passing and enforcing laws.

Similar to the above analysis, the Michigan Court of Appeals in *Taxpayers United for the Michigan Constitution, Inc v Detroit*, 196 Mich App 463; 493 NW2d 463 (1992) evaluated the validity of retroactive tax legislation under the due process standard. Although the court found no due process violation in that case, its analysis relied on the plaintiff's ability to anticipate the legislative change and the improbability that the plaintiffs would have significantly changed their activity to avoid imposition of the tax. *Id.* at 468. Not only was the *Gillette* court's *sua sponte* decision regarding PL 86-272 unanticipated, the Department had assured taxpayers in April of 1989 that RAB 1989-34 could be relied on as binding. Had the Department not issued its purportedly binding assurance that PL 86-272 was the standard, taxpayers would have filed returns or concluded on their own that they were protected and more importantly they would have done so with an understanding of the risk inherent in reaching such conclusions. Taxpayers would have been on notice that the Department was not articulating bright line protection regarding the nexus standard. Taxpayers would then have had an opportunity to modify their business strategy in the state of Michigan consistent with the known risk.

Instead, taxpayers relied on the Department's assurances and are now subject to many years of retroactive tax liability.

### C. **Due Process Protects Equally Against Retroactive Legislation and Statutory Interpretations.**

Before the Court of Appeals most recent decision on this issue, the Department relied on the argument that the law for retroactive legislation does not apply to agency pronouncements. This cannot be true – the same notions of fundamental fairness are involved whether the retroactive imposition of law occurs by act of the legislature or by affirmative interpretations of an executive agency. At least legislative decision-making is subject to public scrutiny and debate where the Department's retroactive application was based on its heretofore unchecked decision-making. The Constitution does not accede a person's due process rights to violation by a specific branch of government – due process is absolute. Fundamental fairness should be as protected from encroachment by agency action as it is from legislative action – both have the force and effect of law.

In Michigan specifically, the Department's regulations and other administrative interpretations of statutes have the force and effect of law. The Department was given statutory authority to promulgate rules and issue bulletins interpreting state tax laws. MCL 205.3. This Court has recognized the authority of an agency's bulletins to have the same force and effect as rules. *Detroit Base Coalition for the Human Rights of the Handicapped, et al v Dep't of Social Services*, 431 Mich 172; 428 NW2d 335 (1988). The Department relied on this authority to advise taxpayers that the proper jurisdictional standard was PL 86-272. Having interpreted the law in its bulletins, the Department should not be permitted to contradict its position retroactively. To do so is no different than imposing a new law retroactively. Had the Department not issued any bulletin, taxpayers could not now be heard to argue that they were misled. Only because the Department took a position should it be precluded from changing that position retroactively.

The Department's SBTB 1980-1 and RAB 1989-46 were intended to establish substantive standards to determine which taxpayers would be subject to the SBT. The bulletins, therefore, should be viewed as having the force and effect of law. While *Gillette* had the effect of overruling the bulletins, up until that decision the Department had unequivocally established the standard pursuant to its legislative grant of authority. As this Court stated in *Clonlara, Inc v Mich State Bd of Ed*, 442 Mich 230; 501 NW2d 88 (1993):

> [l]egislative rules are substantive rules that have the force and effect of law. These rules fill in the interstices of the statute and presumably carry out its intent in greater detail. A court may not substitute its judgment of the content of a legislative rule, but may only strike the rule if the agency lacked statutory authority to adopt it, the agency failed to follow proper procedure, or the rule is unreasonable. *Id* at 240.

*Gillette* effectively struck the Department's position *sua sponte* without providing analysis into the status of the Department's bulletins. While the Court was within its purview to determine the bulletin was unreasonable, such a determination does not excuse the Department's retroactive application of the decision. This Court has an opportunity to review the Department's current attempt to enforce *Gillette* retroactively and determine whether that attempt violates the principles of due process.

### D. <u>Should the Department be Bound by its Published Guidance When Taxpayers Have Relied on That Guidance to Their Detriment?</u>

The ultimate question presented by the present case is whether Michigan will tolerate action by an executive agency, which has misled taxpayers into following and abiding by its published pronouncements and bulletins, and then later penalizes taxpayers that followed the agency's published pronouncements. While the Department was under an obligation to enforce the corrected nexus standard after the *Gillette* decision, the Department's ability to retroactively assess taxpayers for as many open years as were permissible under the applicable statute of limitations is, at best, questionably and, at worst, duplicitous. Regardless of whether the Court applies the *Carlton* line of cases, the Department should be precluded on policy grounds from retroactively assessing taxpayers for periods before *Gillette* was decided. It is critical to the fair and efficient administration of every state's tax laws to ensure that when an administrative agency issues policy directives that require compliance upon pain of penalty and interest, taxpayers who rely on such pronouncements in good faith are not later punished for the government's error. Taxpayers that justifiably rely on promises made by their government should not do so at their peril. No less than the credibility of, and trust in, our government is at stake.

This concept of trust in Government is fundamental and was emphasized by this Court in *Heckler v Community Health Services of Crawford Co, et al,* 467 US 51, n 13; 104 S Ct 2218; 81 L Ed 2d 42 (1984), where the Court stated:

> "See generally *St. Regis Paper Co. v. United States*, 368 U.S. 208, 209 (1961) (Black, J., dissenting) ("Our Government should not by picayunish haggling over the scope of its promise, permit one of its arms to do that which, by any fair construction, the Government has given its word that no arm will do. It is no less good morals and good law that the Government should turn square corners in dealing with the people than that the people should turn square corners in dealing with their Government."); *Federal Crop Insurance Corp. v. Merrill,* 332 U.S., at 387-388 (Jackson, J., dissenting) ("It is very well to say that those who deal with the Government should turn square corners. But there is no reason why the square corners but should constitute a one-way street"); *Brandt v. Hickel,* 427 F.2d 53, 57 (CA 9 1970) **("To say to these appellants, 'The joke is on you. You shouldn't have trusted us,' is hardly worthy of our great government")**; *Menges v. Dentler,* 33 Pa. 495, 500 (1859) **("Men**

> **naturally trust in their government, and ought to do so, and they ought not to suffer for it"**). See also *Giglio v. United States,* 405 US 150, 154-155 (1972). [Emphasis added.]

This fundamental principle that those who justifiably rely on promises made by their Government can do so safely, reflects the strong belief of the Framers of the Constitution:

> "[M]en should not have to act at their peril, fearing always that the State might change its mind and alter the legal consequences of their past acts so as to take away their lives, their liberty or their property. James Madison explained that the people were 'weary of the fluctuating policy' of state legislatures and wanted it made clear that under the new Government men could safely rely on States to keep faith with those who justifiably relied on their promises. *The Federalist, No. 44, at 301* (Cooke ed. 1961).

See, *City of El Paso v Simmons,* 379 US 497, 522; 85 S Ct 577; 13 L Ed 2d 446 (1965) (Black, dissent). See also, *Landgraf v USI Film Products, et al,* 511 US 244, 267; 114 S Ct 1483; 128 L Ed 2d 229 (1994).

Taxpayers, such as International and Lenox, were reasonably justified in relying on the Department's published Bulletins. After all, the State gave them written assurances that they could, and should, so rely. The Department would ask this Court to declare that persons should not, and cannot, rely on assurances made by their Government, for if they do, they proceed at their own peril. This is not good government; and this is certainly not due process of law.

## E. <u>Michigan Case Law Precludes The Retroactive Application on Public Policy Grounds.</u>

The Michigan Supreme Court has previously recognized the importance of these public policy principles and has prevented the Department from punishing taxpayers for the Department's own mistakes. Three years before the Department began retroactively imposing tax for the present issue, the Michigan Supreme Court held that the Department was bound by its first interpretation of a tax law if taxpayers have relied on that interpretation. *In re D'Amico Estate*, 435 Mich 551; 460 NW2d 198 (1990). In *D'Amico*, the Department had for eleven years construed a statute as exempting state lottery proceeds from the inheritance tax. Subsequently, the Department changed its interpretation and sought to apply its new interpretation retroactively. Before the Department changed its interpretation, however, it had issued written guidance which was relied upon by the taxpayer. The Michigan Supreme Court concluded in *D'Amico* that "The Department of Treasury should be held to be bound by the first, contemporaneous construction by the state, at least with regard to the estates of persons who purchased lottery tickets before September 14, 1993, when the Treasury advised inheritance tax field examiners of a 'new development.'" *Id.* at 564.

The Court of Appeals in the present case agreed with the *D'Amico* analysis stating, "*D'Amico* recognizes that a taxpayer should be able to proceed in reasonable reliance on defendant's official positions." *Int'l Home Foods, Inc, et al v Dep't of Treasury*, 268 Mich App 356, 363; 708 NW2d 711, 714 (2005). Applying the principles laid out in *D'Amico*, the Court of Appeals held that the Department, by virtue of taxpayer reliance on previously issued bulletins, was precluded from retroactively applying the nexus standard handed down in *Gillette*. *Int'l Home Foods*, 268 Mich App at 362. While the Court acknowledged the previously published cases of *Syntex v Dep't of Treasury*, 233 Mich App 286; 590 NW2d 612 (1998); *Rayovac Corp v Dep't of Treasury*, 264 Mich App 441; 691 NW2d 57 (2004); and *JW Hobbs v Dep't of Treasury*, 268 Mich App 38; 706 NW2d 460 (2005), those cases did not address the issue the court found controlling:

"[W]hether defendant is bound by its earlier interpretive rulings. ..." *Int'l Home Foods*, *supra*.

The Department seeks to distinguish *D'Amico* from the present case by relying on the unpublished decision of *Topps Co v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, issued June 11, 1999 (Docket No. 203495) (attached hereto and incorporated herein as **Attachment A**). In *Topps*, the Court of Appeals declined to apply *D'Amico*, arguing that *D'Amico* was distinguishable because the Department changed its position before the courts had endorsed that change. *Topps*, at 2. The Court viewed as significant the fact that in *Topps* the Department changed its position after the *Gillette* decision. The Court of Appeals in the present case held that it was not bound by its own unpublished decisions and rejected its previous holding in *Topps* as incorrectly decided. Rather than focusing on whether the Department's interpretation was changed voluntarily or by court decision, the Court placed focus on taxpayer reliance. According to the Court, "[A] taxpayer's reliance does not differ in situations where defendant voluntarily changes its interpretation of a statute or where that change is thrust upon the department by a court decision." *Int'l Home Foods*, 268 Mich App at 363. In either case the Department should be bound by its word – and taxpayers should thus be able to rely on governmental proclamations.

Fortunately, the Court of Appeals' view of governmental responsibility avoids the harsh and inequitable consequences which flow from taxpayer reliance upon incorrect agency direction. Even before the Court of Appeals had decided the present case, the Court recognized in *JW Hobbs*, that "[I]t is unfortunate that plaintiff and other similarly situated businesses are not able to trust the published bulletins of defendant. Defendant's decision to retroactively apply the new standard has blindsided plaintiff, which had correctly complied with the previous taxing standards and planned its business accordingly." *JW Hobbs*, 268 Mich App at 47. Destroying the public trust and blindsiding taxpayers are not characteristics of good government. Only by upholding the certainty of governmental proclamations can Michigan repair the damage done by the Department to the fair administration of its tax laws. Unfortunately, the current perception among taxpayers that Michigan's tax system is unreliable at best – a perception that does not foster voluntary compliance.

If the Department's position is allowed to prevail, the possibility of retroactive application of future tax laws would force taxpayers to take aggressive positions on future tax returns, not only with respect to any item about which there is clear uncertainty but even on issues where the Department has issued clear guidance. The Department's disregard of its word encourages aggressive non-reporting or outright non-compliance, thereby undercutting our voluntary tax collection system. In his dissenting opinion in *JW Hobbs*, Justice O'Connell further described the consequences that will likely result if the Department's position prevails:

> Not only does defendant's sudden policy switch blow a dark cloud over this state's credibility, it forces out-of-state businesses to think twice about doing business in this state. Trust is the cornerstone to a good business foundation, and if an outside business cannot trust this state's interpretation of its own tax laws, how can it trust the state enough to build and grow here? *Id.* at 55. [Citation Omitted.]

**F. <u>Federal Case Law Precludes The Retroactive Application on Abuse of Discretion Grounds.</u>**

Federal courts, recognizing the same public policy principles at play in *D'Amico*, have applied an abuse of discretion standard to retroactively applied regulations. *Gehl Co v CIR*, 795 F2d 1324 (CA 7, 1986); *CWT Farms, Inc v Comm'r,* 755 F2d 790 (CA 11, 1985); *LeCroy Research System Corp v Comm'r*, 751 F2d 123 (CA 2, 1984). Determining if it is an abuse of discretion to apply a regulation retroactively will depend on to what extent the "[R]etroactive regulation alters settled prior law or policy upon which the taxpayer justifiably relied and if the change causes the taxpayer to suffer inordinate harm." *CWT Farms*, 755 F2d at 802. ("Relevant considerations include whether or to what extent the taxpayer justifiably relied on the prior settled law that is altered by the regulation, and whether retroactive application of the regulation would create an inordinately harsh result." *Gehl*, 795 F2d at 1332.)

In *Gehl*, the court found the retroactive change in interpretation to be an abuse of discretion where the Treasury had assured taxpayers they could rely on the original interpretation. The Treasury had issued a pamphlet interpreting a recently enacted law. Regulations were later promulgated that significantly changed the interpretation put forward in the Treasury pamphlet. It is also important to note, as *Gehl* points out, that the federal statute granting authority to promulgate regulations creates a presumption of retroactivity. The Treasury pamphlet, however, promised that any change to interpretation would be applied prospectively. The *Gehl* Court found the government's pamphlet representation dispositive. Having assured taxpayers that they could rely on the statements without fear of liability, *Gehl* found the government's statement "designed to evoke" and "designed to alter business behavior" and refused to allow the government "to renege on such express promises with impunity [as being] grossly unfair." *Id.* at 1333.

The present case is identical to *Gehl* in that the Department's bulletins instructed International and Lenox regarding the law and then guaranteed that they could rely on these bulletins as binding. RAB 1989-34 is unequivocal; it indicates that bulletins may be relied on by taxpayers **unless and until** revoked. Having made such express promises, the Department should not be allowed to renege.

In *LeCroy*, the Court recognized judicially enforceable limits on the government's discretion to ignore prior assurances given to taxpayers. The Court concluded that the reasons to limit the government's discretion were overpowering where the government had given taxpayer assurances of prospectivity. "An ongoing power to dishonor deliberately created expectations will deter private parties from seeking to take advantage of proffered tax benefits designed to encourage particular economic activity." *LeCroy*, 751 F2d at 128. Had no assurance been made, the Court would have upheld the retroactive application of the regulation. In light of the government's assurance, such retroactive application was an abuse of discretion.

Both the *Gehl* and *LeCroy* decisions view retroactive change with disdain when the agency has given assurance that any change will apply prospectively. As put by the *LeCroy* Court, "[T]he retroactive application of regulations in the face of a promise of prospectively smells of a bushwhack." *Id.* at 128. In the present case, departmental assurance in RAB 1989-34 was designed to guide companies doing business in Michigan, guaranteeing them protection from the SBT under PL 86-272. Having engaged in business pursuant to that assurance, International Home Foods and Lenox are now faced with an attempt by the Department to renege on its guarantee.

## III.
## CONCLUSION

This Court should uphold the Court of Appeals' decision and make clear that due process and good government will protect taxpayers from the Department's retroactive imposition of tax when the agency itself published guidance later determined to be incorrect. The State of Michigan has a long history of honoring its pledges made in the course of giving advice to its citizens; the Department's actions here should not be allowed to undermine that record.

Respectfully submitted,

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Date: December 4, 2006

# STATE OF MICHIGAN

# COURT OF APPEALS

TOPPS COMPANY, INC,

Plaintiff-Appellant,

v

DEPARTMENT OF TREASURY,

Defendant-Appellee.

UNPUBLISHED
June 11, 1999

No. 203495
Court of Claims
LC No. 96-016324 CM

Before: Smolenski, P.J., and Saad and Gage, JJ.

PER CURIAM.

Plaintiff appeals by right a Court of Claims order denying its motion for reconsideration of an order granting defendant's motion for summary disposition. We affirm.

I

Prior to 1993, the Department of Treasury did not assess taxes under the Single Business Tax Act (SBTA), MCL 208.1 *et seq.*; MSA 7.558(1) *et seq.*, unless the taxpayer's business activities had a sufficient nexus with the state of Michigan pursuant to PL 86-272, codified at 15 USC 381. *Syntex Laboratories v Dep't of Treasury*, 233 Mich App 286, 288; __ NW2d __ (1998). In *Gillette Co v Dep't of Treasury*, 198 Mich App 303; 497 NW2d 595 (1993), this Court held that PL 86-272 did not apply to taxes imposed under the SBTA, and that the proper test is the Due Process/Commerce Clause test set forth in *Quill Corp v North Dakota*, 504 US 298; 112 S Ct 1904; 119 L Ed 2d 91 (1992). In accordance with the *Gillette* decision, defendant determined that plaintiff was liable for the SBT for fiscal years 1990-1993.[1] Defendant paid the assessment under protest, but filed a complaint in the Court of Claims for return of the money. Applying *Gillette* retroactively, the Court of Claims granted defendant's motion for summary disposition. Plaintiff now appeals.

II

Plaintiff argues that the trial court erroneously gave retroactive application to this Court's 1993 decision. This Court has already held that *Gillette* is properly applied retroactively. *Syntex, supra*, 233 Mich App 292-293.



Exh A

III

Plaintiff further argues that defendant should be estopped from collecting past single business taxes. We disagree.

Estoppel arises when "a party, by representations, admissions, or silence intentionally or negligently induces another party to believe facts, the other party justifiably relies and acts on that belief, and the other party will be prejudiced if the first party is allowed to deny the existence of those facts." *Westfield Companies v Grand Valley Health Plan,* 224 Mich App 385, 390-391; 568 NW2d 854 (1997). Here, plaintiff paid taxes under the SBTA in fiscal years 1990 and 1991, *before* Michigan collected this tax from businesses in plaintiff's circumstances. Accordingly, plaintiff cannot now argue reliance on defendant's prior position. Additionally, defendant never misrepresented *facts*; rather it asserted a legal position that was subsequently deemed contrary to Michigan law. Furthermore, defendant's representation of the law was neither intentional nor negligent. Rather, its position was based on a good-faith understanding of Michigan law. See *Adams v Detroit*, 232 Mich App 701, 708; __ NW2d __ (1998), holding that "[e]quitable estoppel arises where one party has *knowingly concealed* or *falsely represented* a material fact, while inducing another's reasonable reliance on that misapprehension, under circumstances where the relying party would suffer prejudice if the representing or concealing party were subsequently to assume a contrary position."

Additionally, estoppel is inapplicable because defendant did not change its position regarding plaintiff's immunity from taxation under the SBTA, but rather was required by this Court to change its policy. Defendant's reliance on *In re D'Amico Estate*, 435 Mich 551; 460 NW2d 198 (1990), is misplaced. In *D'Amico*, the Treasury Department first changed its position, and later had its change endorsed by the courts. *Id.*, 559 n 11. Thus, the Department changed its position *before being required to do so* pursuant to a court order. *Id.*, 564. Conversely, in this case, defendant changed its position only *after it was forced to do so* by an order of this Court. *Gillette, supra*, 198 Mich App 311. Estoppel therefore does not apply.

IV

Finally, plaintiff contends that defendant's retroactive application of the due process/commerce clause test violates plaintiff's constitutional rights under the Due Process Clause, US Const, Am V, XIV. We disagree.

The Supreme Court has held that retroactive application of a tax does not violate due process simply because taxable events transpired before the taxing statute was passed. In *Welch v Henry*, 305 US 134; 59 S Ct 121; 83 L Ed 87 (1938), the Supreme Court stated:

> [t]he objection chiefly urged to the taxing statute is that it is a denial of due process of law because in 1935 it imposed a tax on income received in 1933. But a tax is not necessarily unconstitutional because retroactive. . . . Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged

to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process, and to challenge the present tax it is not enough to point out that the taxable event, the receipt of income, antedated the statute. [*Welch, supra*, 305 US 146-147 (citations omitted).]

More recently, the United States Supreme Court held in *United States v Carlton*, 512 US 26; 129 L Ed 2d 22; 114 S Ct 2018 (1994), that a retroactive amendment to a tax statute did not violate due process where the retroactive period was of reasonable length (slightly more than one year) and where the government's purpose was neither illegitimate nor arbitrary. *Id.*, 32-33. In *Carlton*, the executor of a decedent's estate challenged an amendment which restricted the availability of an estate tax deduction. The executor of a decedent's estate had engaged in a particular transaction for the sole purpose of taking advantage of the deduction. *Id.*, 28-29. The Court rejected the executor's due process argument, noting that there was "no plausible contention that Congress acted with an improper motive, as by targeting estate representatives such as Carlton after deliberately inducing them to engage" in the transactions at issue. *Id.*, 32. The Court further noted that the executor's reliance, by itself, was insufficient to establish a constitutional violation because "[t]ax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code." *Id.*, 33. Finally, the Court stated that the executor's lack of notice regarding the amendment was not dispositive because "a taxpayer 'should be regarded as taking his chances of any increase in the tax burden which might result from carrying out the established policy of taxation.'" *Id.*, 34, quoting *Milliken v United States*, 283 US 15, 23; 51 S Ct 324; 75 L Ed 809 (1931).

Relying on *Carlton*, the Third Circuit held in *Tate & Lyle, Inc v Commissioner of Internal Revenue Service*, 87 F3d 99 (CA 3, 1996), that a retroactive application of a tax *regulation* did not violate the Due Process Clause although the six-year retroactive application period was longer than that contemplated by *Carlton*. *Id.*, 107. The Court found that *Carlton* was distinguishable because "*Carlton* involved the retroactive application of a *statute*, and here we are dealing with the retroactive application of a *regulation*." *Id.* (emphasis in original).

In the case before us, we find no basis for plaintiff's contention that the retroactive application of *Gillette* violated due process. There is no indication that defendant's conduct in collecting back SBTA taxes was arbitrary or capricious. Additionally, the circumstances here present a less compelling case against retroactive application. *Carlton* involved retroactive application of a statutory amendment; *Tate & Lyle*, a regulation. Here, the SBTA has been in existence throughout the relevant period; only the interpretation of that statute is being applied retroactively. Accordingly, we find no due process violation in the retroactive application of *Gillette*, notwithstanding lack of notice or plaintiff's alleged reliance.

Plaintiff's arguments to the contrary are unpersuasive. Plaintiff cites *Welch, supra,* 305 US 134, and *United States v Hemme*, 476 US 558; 106 S Ct 2071; 90 L Ed 2d 538 (1986), and then states that

[c]learly, Topps could not have altered its behavior to avoid incurring SBT under the *Gillette* jurisdictional standard because it could not have anticipated application of the

*Gillette* standard prior to *Gillette*. Second, tax should not be retroactively applied if the taxpayer did not have notice of the tax when the taxpayer engaged in the transaction.

Plaintiff refers to a "transaction" because it relies on a case involving gift taxes, wherein a specific gift was made and taxed two years later on the death of the donor. *Hemme, supra*, 476 US 563. The United States Supreme Court has made clear that the analysis applicable to gift taxes, which might affect vested rights, is not the same analysis to be applied to other taxes, which generally do not affect vested rights:

> In the cases in which [the Supreme] Court has held invalid the *taxation of gifts* made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. [*Welch, supra*, 305 US 147 (emphasis added).]

The case at bar does not involve a gift tax; therefore, plaintiff's reliance on the *Hemme* case is misplaced.

Affirmed.

/s/ Michael R. Smolenski
/s/ Henry William Saad
/s/ Hilda R. Gage

[1] Plaintiff paid the SBT in 1990 and 1991, though it later sought return of that money.